

Social Benefit Bonds Pilot Program

Principles

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Introduction

In the 2015-16 Budget, the Queensland Government announced that Social Benefit Bonds (SBBs) will be tested to help resolve complex social issues affecting Queenslanders. The pilot will focus on delivering bonds in the areas of re offending, homelessness and issues facing Aboriginal and Torres Strait Islander people.

SBBs are an alternative way to work to deliver both social and financial returns. Government and non-government sectors face increasing demand for services. With limitations on funding available to government, it is not possible to fund every program to meet all needs (or demands).

SBBs are outcomes driven. They provide a financing structure where government only pays for improved social outcomes when demonstrated – as opposed to when services are delivered. Additional funds will be attracted from private investors to finance new social services and generate positive outcomes. When contracted outcomes are demonstrated, the invested funds plus a return are paid to investors. If agreed outcomes are achieved, associated service delivery costs to government will be avoided over the long term and the resulting savings are available to fund the payments to investors.

SBBs are a relatively new form of outcomes-based or social impact investment. The first SBB commenced in 2010 in the United Kingdom. At 1 March 2015, there were 38 active SBBs around the world – including the first two SBBs in Australia piloted by New South Wales in 2013. Based on the experience of these jurisdictions, SBBs are complex and unique transactions requiring extensive documentation to support multiple stakeholders.¹

While each SBB is unique in its structure and nature, common foundations are needed for SBBs to operate and deliver in the Queensland environment. Based on social impact investment experiences in other jurisdictions and to have the best chance of delivering the social outcomes, the service at the heart of the SBB transaction needs to:

- Focus on individuals or clients within a target population (or cohort) who are willing to participate in the service
- Be delivered by a capable service provider or consortium of service providers with the appropriate skills and experience
- Apply clear evidence that the proposed intervention addresses the social issue through either direct experience by the service provider or from other jurisdictions
- Minimise adverse outcomes for the target population/cohort.

In light of the common foundations needed to support such unique transactions, the Queensland Government is taking a principles-led approach to SBBs.

¹ [The Potential and Limitations of Impact Bonds: Lessons from the First Five Years of Experience Worldwide \(July 2015\)](#)

Principles

Learning from the experience of other jurisdictions (both overseas and in Australia), the Queensland Government is looking for SBBs that:

1. Focus on prevention and early intervention services which make a difference for Queenslanders (*Policy Delivery*)
2. Deliver positive social outcomes through capable service providers delivering services that are known to work (*Social Outcomes*)
3. Use trusted measures, which are robust, defensible and repeatable, to demonstrate that the expected social benefits are being delivered (*Trusted Measures*)
4. Deliver value for money for Queensland by only entering transactions with net financial benefits over time (*Value for Money*)
5. Seek commitment from all parties delivering a transaction to approach negotiations in good faith and to develop strong working relationships (*Commitment*).

These principles will inform all aspects of the SBB – from how the Queensland Government communicates with stakeholders to how it approaches negotiations and, ultimately, contracts. This document articulates what each of these principles mean in the SBB context.

Principle 1: Policy Delivery

To focus on prevention and early intervention services which make a difference for Queenslanders

Complex and persistent social issues typically result in Queenslanders receiving acute services in a crisis situation (such as single or multiple hospital stays or being incarcerated). Acute or crisis services are characteristically high cost due to the need for skilled staff to be on hand and/or significant infrastructure required to deliver these services. The cost impact of these services is compounded by the fact that the demand for acute and crisis services is increasing over time.

While SBBs provide an avenue for governments to explore alternative ways to fund and procure services that address complex and persistent social issues – like homelessness, reoffending and issues affecting Aboriginal and Torres Strait Islander people, the Queensland Government will continue to deliver crisis and acute services. Rather than replacing existing services, SBBs will enable the Queensland Government to access private sector funding to deliver complementary prevention and early intervention services.

SBBs are likely to be more effective when they target prevention and early intervention services, as evidence suggests these are more effective in addressing social issues.² Prevention services focus on stopping or avoiding the social issue arising or having impact in the first instance. Early intervention services are provided either early in an individual's life

² [The Potential and Limitations of Impact Bonds: Lessons from the First Five Years of Experience Worldwide \(July 2015\)](#)

or early in the development of an issue or problem affecting an individual. Addressing social issues early or at the root cause can avoid demand for costly crisis and acute services in the medium to long term, which provides opportunities to direct savings into other social priorities.

The success of a SBB is measured by the degree to which the service makes a measurable difference for recipients. The service provider leads the design of a service aimed at addressing the social issues impacting an individual or recipient. Measuring this success is dependent on being able to identify the target or cohort group, who are at the heart of this transaction. As SBBs are focused on individuals and their needs, improvements for the support networks, including family and friends, can also be made possible by the service.

The Queensland Government's objective is to address the nominated complex social issues to complement existing services.

Principle 2: Social Outcomes

To deliver positive social outcomes through capable service providers who are known to deliver services that work

SBBs are a Payment-by-Outcome or Payment-by-Results transaction where government only pays when agreed social outcomes are met. Moving from outputs (or *what we do*) to outcomes (or *what we achieve*) is a paradigm shift.

By focusing on outcomes, the service is targeted at addressing fundamental causes of the social issues and aims to improve the lives of vulnerable Queenslanders. This life improvement or transformation is a driver for government participation in SBBs.

SBBs provide service providers with flexibility for innovation in service delivery as they provide ready, longer term funding for social programs. As with any innovation, an evidence base must be established including the counterfactual for baselining to ensure that the claimed benefits can indeed be delivered.

Focus on individuals

The individual or recipient must be at the heart of the service design and delivery. The positive impact on the lives of the recipients of services is dependent on the overall social outcomes or benefits arising from a SBB.

To make this difference, government needs to identify and agree the cohorts who will have the opportunity to access services generated through the SBB. It is important that once those with a genuine need have been identified that they are engaged and have an understanding of how and why the service has been developed. Effectively, government aims to ensure that the right people are getting the right service when needed.

'Right' service provider/s

Another element of delivering positive social outcomes is getting the 'right' service provider. Commonly, this is a service provider with the relevant experience, skilled people and strong organisational governance.

Previous experience in delivering an identical or similar service commonly demonstrates ability to deliver the proposed service. While these characteristics may not guarantee success, they are general indicators of capacity and capability.

A capable service provider plays a pivotal role in the design and establishment of the service (or intervention) at the heart of a SBB. As a key player in the SBB partnership, service providers must work collaboratively with community stakeholders, social sector and investors.

Reliability is a desirable attribute for service providers as investors must have sufficient confidence to make the required investment to support the SBB.

From a Government perspective, the service provider must have the experience, capability and capacity to engender confidence in their ability to reliably deliver quality services. Additionally, Government must have confidence in both the service provider and the service being delivered before referring individuals to a new service. This would also be true from the recipients' perspective, they have to believe that the service will be of benefit before participating. This highlights the importance of the credentials of the service provider in fostering trust and confidence from these stakeholders.

Given the nature of the transaction, a common view is that SBBs are only for large service providers. This may be the case in certain situations. However, there are opportunities for smaller organisations to form consortia – particularly when the service requires an integrated services approach.

Evidence the service works

A strong evidence base demonstrating how the proposed service will work to deliver the expected outcomes is necessary to inform decisions about the SBB. Good data to back up claims of how the service will deliver outcomes is essential. This is important for both investors deliberating over investment options and governments who are putting together and managing SBB arrangements.

The evidence base could be from previous or current experience, formal research papers, recognised program evaluation methods, or a combination of sources. Effectively, there needs to be a clear and strong evidence base supporting the proposed service.

This evidence base is also important to qualify the likely positive outcomes claimed. It will be necessary to consult potential recipients and close communities to ensure the service does not create any unintended consequences for the target cohort.

The Queensland Government's objective is to generate positive social outcomes for Queenslanders through the delivery of the right service by the right provider.

Principle 3: Trusted Measures

To use trusted measures, which are robust, defensible and repeatable, to demonstrate that the expected social benefits are being delivered

As government only pays investors if the agreed social outcomes have been delivered, it is necessary to demonstrate that a difference is made based on intended social outcomes for recipients. How this is demonstrated is dependent upon how each outcome is defined and measured over time.

Measures are important for a SBB as they are used by:

- service providers to show what outcomes have been delivered
- financial intermediaries and investors as the basis of how they will achieve their return
- Government to know what outcomes have been delivered and whether to pay.

A SBB needs to be supported by a strong measurement framework with appropriate data sources which define the transaction.

The measurement framework sets out how the data applies to a refined set of metrics (i.e. targets for the SBB to achieve). At a minimum, metrics need to be robust, defensible, repeatable and transparent. Importantly, they also need to be agreed amongst all parties to the SBB.

The data used to underpin SBBs must come from verifiable sources that deliver high quality data that remains reliable over the life of the transaction. The data can be sourced from either existing public sources or from within existing information held by Government.

While identifying clean, reliable and verifiable data may be time consuming, a key benefit arising from the implementation of Payment-by-Outcomes, and specifically SBBs, is improved data and outcome measurement systems for all participants.

Measuring the outcome

Outcomes, and their associated measures, will be unique to each SBB as they must reflect the proposed service and the associated business model. This means the metrics selected must align with the social and financial benefits expected to result from the service. They should also be straight forward and easy to understand.

It is preferred that metrics on the cohort and the expected outcomes have been captured over a period of time. These historic metrics provide a robust basis for the development of the service and in defining the expected social outcome.

In some areas, there may not be outcome metrics available in Queensland. In this case, agreed proxy measures could be adapted from other sources – whether that is from other disciplines, services and/or jurisdictions – and correlated with the desired outcomes.

There also needs to be a clear way to measure performance of the SBB, which is done by establishing a counterfactual (or baseline) from which to measure the social change or outcome. For example, a control group of individuals that qualify but do not receive the

service could be established against which the outcomes of the service will be compared. While its nature may vary, the counterfactual must be an objective and evidence-based approach to confirming the difference that the service has made in the individual's life.

It is also important to avoid any perverse incentives, such as unexpected activity impacts or enabling *gaming* of the business model (for example, only selecting target populations with the highest likelihood of achieving the outcome).

Verifying and repeating data collection

Given the duration of a SBB transaction (approx. 5-7 years), it is important that the process of accessing and verifying data can be repeated on a regular basis. Data transformations and business rules must be documented to aid repeatability of data loading processes. The data source must continue to be updated and available on a timely basis across the life of the SBB.

The ability to simplify a transaction into a set of easily understood outcomes depends upon all aspects of the transaction being defined.

At a minimum, it must be easy to identify:

- who are the clients (or target population/cohort)
- what are the services
- what are the cost impacts of those services
- what are the expected outcomes.

By being able to communicate and agree all of these aspects of the transaction, all parties should have a clear understanding of their role and responsibilities in the resulting contracts.

As reporting on these measures determines whether payments are made under the SBB, these are often verified by an independent verifier. It is typically on the advice of the verifier that payment to the investor is triggered.

The Queensland Government's objective is for SBBs to be supported by trusted data and measures that demonstrate agreed positive outcomes have been delivered.

Principle 4: Value for Money

To deliver value for money for Queensland by only entering transactions with net financial benefits over time

Social Impact Investment strategies, such as SBBs, seek to create both financial returns and positive social impacts that can be measured and evaluated.

For government, achieving the defined social outcome is expected to reduce demand and, in turn, expenditure on acute and crisis services. The savings generated as a result of avoided costs can then be accessed by government to repay the principal and provide a return to the investor. If these financial benefits cannot be demonstrated or are insufficient, there would be no clear case for a SBB.

SBBs must clearly demonstrate that the expected benefits outweigh the associated costs, before proceeding - there needs to be unequivocal evidence that the SBB is delivering a return on investment for Queensland.

Government and its agencies will want to see the benefits arising from the SBB converted into cash movements, whether that is savings or reallocations over the several years that the SBB will operate

Scalability (or size) of the transaction is also important as it aids in reducing the cost of the service per incidence of intervention. For example, the costs of establishing the framework to deliver a service tend to be one-off in nature and would potentially be commercially viable if this cost could be spread across more, rather than less, incidences of service (or intervention).

SBBs and associated services need to be scaled to ensure a targeted service is deliverable and of sufficient size to demonstrate a genuine and statistically supported result. In addition, achieving the right scale of transaction also makes the resource investment (such as time and effort) of negotiating and contracting a SBB worthwhile.

The social issues being addressed by SBBs may impact a number of government agencies and, potentially, across different levels of government (i.e. local, state and federal). For example, an individual who is homeless may seek health and housing services and may also come to the attention of police. The nature of the interaction with these services is likely to vary from individual to individual and across social issues.

It is anticipated that some of these benefits can be readily quantified while others may be best described in qualitative terms. Overall, there needs to be clear evidence that there is an overall net benefit to Queensland over time arising from the SBB and its proposed service. The narrative around the net benefits to Queensland needs to be both clear and broad to ensure that both quantitative and qualitative benefits arising are acknowledged.

The Queensland Government's objective is to deliver value for money by entering into SBBs that deliver sustainable financial benefits for Queenslanders.

Principle 5: Commitment

To seek commitment from all parties delivering a transaction to approach negotiations in good faith and to develop strong working relationships

SBBs are relatively complex and high cost social impact investment transactions with a medium term. The risk exposure – both the extent and the nature of those risks – varies across stakeholders involved in the SBBs.

Each participant in a SBB will need to determine their capacity to engage with the process and to manage the risks associated with the transaction. To effectively manage the process and its associated risks, will require clear commitment in the negotiation process by all parties involved – including investors, service providers and government.

Risks and returns of SBBs

Investors and financial intermediaries are likely to bear the financial risk associated with the SBBs – but also share in the financial return from a successful SBB. How this risk is shared across these parties is dependent on the structure of the resulting SBB.

Service providers (especially Non-Government Organisations) are likely to bear the operational risks associated with delivering the service and achieving the outcomes identified in the SBBs. To take on this role, Non-Government Organisations will be required to demonstrate their capacity and capability to participate in the SBB. As payment depends on evidence of outcomes delivered, Non-Governments Organisations will need to review data approaches to ensure required evidence is available over the life of the SBB transaction.

Each participant in the SBB will have a unique risk-return profile that it will need to assess and determine if it is acceptable to proceed with the proposed SBB transaction. This assessment is the responsibility of each participant.

Like other participants in the process, the Queensland Government will make its own assessment of the risk-return profile of the proposed SBB transaction. If this profile is not appropriate, the Government, like other participants in the transaction, will not be able to participate in the transaction.

For SBBs to be successful, all parties – investors, service providers and the Queensland Government – need to be committed to the process and the long term nature of the underlying SBB (typically between 5 and 7 years). This commitment involves ensuring that each party has the capacity and capability to actively participate in both creating and delivering the transaction over time.

Collaboration

The success of social impact investment tools, like SBBs, in part depends upon the ability and capacity of all parties to work in collaboration. There needs to be extensive and ongoing collaboration across all sectors – including government, social services and investor sectors.

The intention and commitment to collaborate is fundamental, but will not be enough to create success if they are not supported by workable governance, operational and reporting frameworks. From an operational perspective, there needs to be clarity as to the expected role of key players. For example, the proposed level of government involvement in providing support functions for delivering the service, in terms of referral processes, policy and reporting frameworks must be determined.

The Queensland Government's objective is to negotiate in good faith and to develop strong positive working relationships to give the SBBs the best possible chance of delivering outcomes for Queenslanders.

Where to now?

Additional information on the pilot SBBs will be made available in the near future on the SBB Program's website - www.treasury.qld.gov.au/sbb

Investors and organisations interested in participating in a SBB or other Social Impact Investment should speak to their financial advisor or contact Social Impact Investment intermediaries in the first instance.

Jurisdictions in Australia and around the world are investigating or adopting forms of Social Impact Investment – including Social Benefit Bonds. Below are links to repositories of information available in other jurisdictions that may be useful in developing an understanding of this topic:

Australia

- New South Wales (NSW) - The [Social Impact Knowledge Hub](#) is overseen by the Office of Social Impact Investment within the NSW Government
- South Australia (SA) – The [SA Government](#) are currently exploring Social Impact Bonds.

Overseas

- United Kingdom (UK) – The Centre for Social Impact Bonds [Knowledge Box](#) captures the experiences of the UK across a range of Social Impact Bonds.
- New Zealand – The Government is piloting social bonds, led by the [Ministry of Health](#).

Other countries active in SBBs or Social Impact Investment include the United States, Belgium, Canada, Germany, Ireland, and The Netherlands.

In addition to government research, a range of international research and information from other organisations active in this area is available, including:

- United States – the MaRS Centre for Impact Investing has a [Social Impact Bond Technical Guide for Service Providers](#)
- United State – the [Social Impact Bond Technical Assistance Lab](#) at the Harvard Kennedy School has a range of publications available
- United Kingdom – Social Finance, a not for profit organisation, has a [Technical Guide to developing Social Impact Bonds](#)
- United Kingdom – the Early Intervention Foundation, a charity organisation, has a [guide](#) to using social investment, with a focus on Social Impact Bonds
- Israel - [Social Finance Israel](#) is a financial intermediary and has announced its intention to develop SBBs in employment, reoffending, health and education.